ERISA Fiduciary Insurance

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This practice note discusses the use of fiduciary insurance in protecting fiduciaries from liability when managing or providing services to employee benefit plans subject to the Employee Retirement Income Security Act (ERISA). Fiduciary liability insurance is an important, but sometimes overlooked, aspect of a company's risk management plan. This type of insurance covers liabilities resulting from fiduciary errors or omissions when operating employee benefit plans. The insurance is optional and is not a substitute for a fidelity bond or directors and officers (D&O) liability insurance policy, which typically don't provide the scope of coverage that may be necessary to protect the risks imposed upon fiduciaries by ERISA.

The practice note is organized around the following topics:

- ERISA Fiduciary Duties Generally
- Using ERISA Fiduciary Insurance
- Fiduciary Liability Policy Provisions
- Indemnification of ERISA Fiduciaries

See Employee Benefits Law § 12.07, Section 3(b)(ii)(B) for a further discussion of these issues.

ERISA Fiduciary Duties Generally

ERISA imposes personal liability on fiduciaries who have breached their fiduciary duties, causing a plan to incur losses. See ERISA § 404 (29 U.S.C. § 1104). ERISA also imposes joint and several liability among multiple fiduciaries who are responsible for a breach and, in some cases, on a non-breaching co-fiduciary for the breach of another co-fiduciary. ERISA § 405 (29 U.S.C. § 1105). The liability can arise from a host of reasons related to a fiduciary's activities, including the selection of investments, engaging in transactions that present a conflict of interest, failing to pay a participant the benefit amount due under the plan, or participating in an act of self-dealing. See ERISA § 406 (29 U.S.C. § 1106). A fiduciary may also be liable for the acts of any agent it hires and must exercise the standard of care required by ERISA when selecting any plan vendor. ERISA § 409(a) (29 U.S.C. § 1109(a)). For example, an ERISA fiduciary may be challenged in its choice of an insurer that will satisfy plan liabilities in a terminated plan or the investment manager that manages all or a portion of plan assets.

ERISA defines the term "fiduciary" for purposes of applying the ERISA statutory fiduciary duties and obligations. ERISA § 3(21) (29 U.S.C. § 1002(21)). The nearly identical IRC provision, I.R.C. § 4975(e)(3), sets forth the fiduciary definition for purposes of the I.R.C. statutory and regulatory prohibited transaction rules. Those IRC fiduciary definitions provide that any person (including any entity) is a plan fiduciary to the extent such person is either identified in the plan as a named fiduciary, or performs the following activities:

- **Manages or invests plan assets.** The individual or entity exercises any discretionary authority or control over plan management or exercises any authority or control, whether or not discretionary, over the management or disposition of plan assets.
- **Provides investment advice.** The individual or entity renders (or has the authority or responsibility to render) to the plan investment advice for a fee or other compensation, whether direct or indirect. –or–
- **Administers the plan.** The individual or entity has any discretionary authority or responsibility in the plan's administration.

ERISA §§ 3(21)(A), 402(a) (29 U.S.C. §§ 1002(21)(A), 1102(a)). See also I.R.C. § 4975(e)(3). Even if a fiduciary is not identified as such in the governing documents, an individual or entity may still be a fiduciary based on functional terms of control and authority over plan assets. E.g. Martin v. Feilen, 965 F.2d 660 (8th Cir. 1992). ERISA fiduciaries are increasingly exposed to liability in making decisions relative to ERISA employee benefit plans and, given the risk of personal liability, require financial protection in the event they incur liability under ERISA. Unique issues exist both with respect to the types and extent of that protection.

To learn more about ERISA fiduciary duties, see ERISA Fiduciary Duties. Also, see Prohibited Transaction and Parties in Interest Checklist (ERISA Rules) to identify various prohibited transactions which, if violated, may lead to fiduciary liability.

Using ERISA Fiduciary Insurance

A fiduciary insurance policy protects employers and their plan fiduciaries from fiduciary-related claims for the alleged mismanagement of plan assets or failure to follow ERISA rules in the control or management of plan assets and payment of benefits, subject to such policy's terms, conditions and exclusions (many of which are discussed herein). The coverage is not required but is recommended.

Would be claimants include:

- Plan participants and beneficiaries
- Plan fiduciaries –and–
- • Government enforcement/regulatory groups such as the Department of Labor (DOL), and for most defined benefit plans, the Pension Benefit Guarantee Corporation ERISA § 502(a) (29 U.S.C. § 1132(a)).

On limited occasion, the U.S. Securities and Exchange Commission and State attorneys general may sue the plan or plan sponsor for acts or omissions.

Coordinating D&O and Fiduciary Liability Insurance Coverage

At first glance, employers may believe that their D&O insurance policies extend coverage to claims against ERISA fiduciaries, but D&O policies typically exclude ERISA violations. As a first step to evaluating the adequacy of fiduciary liability coverage review the client's D&O policy to confirm whether it excludes ERISA violations (whether entirely or partially). If it does, you will need to assist the client in adopting a fiduciary insurance policy or will want to review any existing, separate fiduciary insurance policy for the adequacy of fiduciary protection. Keep in mind that even in the absence of an explicit ERISA exclusion, there may be no ERISA coverage under a D&O policy, as D&O insurance covers directors' and officers' management of the entity, and fiduciary obligations to employee benefit plans typically fall outside the scope of this intended coverage. Therefore, a D&O policy without an ERISA exclusion still might not cover ERISA violations.

Where the plan sponsor or its ERISA fiduciaries already have fiduciary insurance, evaluate the sufficiency of that coverage, gaining insight from the plan sponsor's risk management group, if possible. Consider that fiduciary liability exposure may have changed since the plan sponsor last purchased or assessed fiduciary liability insurance policy coverage. Advise the plan sponsor about the general need to reevaluate coverage periodically. For example, excessive fee litigation cases have increased in both volume and severity so if the client has a large 401(k) but has not reviewed or negotiated record-keeping or other fees associated with the plan, consider specifically addressing this potential exposure. Similarly, a publicly traded company that has added an employer stock investment to its 401(k) plan should consider coverage to address a possible "stock drop" challenge (more on "stock drop" challenges to be discussed later).

For a further discussion on D&O coverage, see Director and Officer (D&O) Insurance.

Other Insurance

While fiduciary liability insurance protects plan sponsors and their ERISA fiduciaries (officers, directors and other individuals, although not third-party service providers) plan

sponsors may need to control other risks related to their employee benefit plans. Discuss the following additional types of insurance with your client. Each is similar to, but distinct from, fiduciary liability insurance.

Employee Benefits Liability Insurance

While fiduciary liability insurance primarily covers claims alleging breach of ERISA fiduciary duties, employee benefits liability insurance covers claims involving administrative errors that are not treated as breaches of fiduciary duty. For example, a failure on the part of plan personnel to name a beneficiary on a life insurance policy is an administrative act normally not covered under fiduciary liability insurance. Advise the plan sponsor on how best to coordinate these two types of coverage. Many fiduciary liability policies automatically include employee benefits liability coverage, or make it available as an endorsement. On the other hand, stand-alone employee benefits liability policies generally do not cover fiduciary liability exposures. Explore whether the fiduciary insurance coverage extends to administrative errors and fill any gaps in coverage.

IRS Liability Insurance

Under the Employee Plans Audit Closing Agreement Program (audit CAP), which is part of the Employee Plans Compliance Resolution System (EPCRS) for correcting qualified plan errors (see EPCRS Correction Rules and Procedures), the IRS can impose monetary penalties on trustees for failing to operate a retirement plan following IRS qualification requirements. Rev. Proc. 2016-51, 2016-2 C.B. 466, Part VI, § 13, 14. The IRS may impose penalties for not following the terms of plan documents even if plan operation complies with IRS qualification requirements.

Civil penalties, like audit CAP monetary sanctions, are not covered under a standard fiduciary or employee benefits liability policy. And most standard fiduciary liability policies do not cover the costs of correcting disqualifying defects for which a plan fiduciary is responsible. In both instances, plan sponsors bear the liability. Even where a fiduciary liability insurance policy includes audit CAP coverage, the coverage typically does not exceed a sub-limited amount (e.g., $100,000). Plan sponsors may want to consider purchasing a separate IRS fiduciary liability insurance product to protect itself and its internal fiduciaries against liability arising from a disqualifying plan operational failure. Some carriers offer enhanced audit CAP coverage as well as coverage for the cost of IRS corrections required resulting from an audit.

Cyber Insurance

Fiduciaries may wish to explore the possibility of purchasing insurance policies explicitly covering cybersecurity and privacy risks. The risk may extend to employee benefit plans. It is unclear whether fiduciary liability insurance policies will respond to liability related to state law causes of action (that are not preempted), for data breaches as opposed to liability resulting from a breach of an ERISA fiduciary duty relating to a privacy or security breach. Cybersecurity insurance may provide coverage not only for liability resulting from a security breach, but also the costs of any required notifications and other recovery stepfavs associated with a privacy or security breach. These policies can provide coverage even if the breach has not, and may never, trigger a liability claim by an injured party.

For a further discussion on a plan sponsor's exposure for cyber-security risks, see Privacy Risks for Retirement and Other Non-Health Benefit Plans.

ERISA Fidelity Bonding Insurance

A fidelity bond involves a contract with an insurance company or other issuer agreeing to reimburse a benefit plan for losses resulting from dishonest acts (e.g., theft and fraud) by persons who handle plan assets. ERISA requires all plan trustees and employees who handle plan funds to be bonded. Generally, unless an exception applies, ERISA plan officials **must** be bonded for at least 10% of the amount of funds they handle, subject to a minimum threshold and maximum amount of $500,000 per person. ERISA § 412 (29 U.S.C. § 1112). The maximum may be higher in circumstances involving employer securities.

An exception to the bonding requirement exists for corporate trustees and insurance companies that have a combined capital and surplus of at least $1 million. Other exceptions apply where:

- The only assets from which benefits are paid are from the employer's general assets or union funds –or–
- The entity is a registered broker dealer and subject to bonding requirements under 15 U.S.C. § 78c(a)(26)

ERISA § 412(a)(3) (29 U.S.C. § 1112(a)(3)). Other exceptions apply. See ERISA § 412(a)(1), (2) (29 U.S.C. § 1112(a)(1), (2). For further discussion of the ERISA bonding requirement, see ERISA Bonding Requirements.

Fiduciary Liability Policy Provisions

While fidelity bonds are mandatory under ERISA § 412, they protect ERISA employee benefit plans against intentional wrongdoings, like embezzlement, and don't cover fiduciary liabilities. However, fiduciary liability insurance provides coverage for loss arising from claims based upon the

unintentional acts of the plan fiduciaries, the plan sponsor, and benefit plans. Such coverage, however, is optional and discretionary. See ERISA § 412 (29 U.S.C. § 1112).

Fiduciary liability policies generally:

- Pay for the cost of defending plan fiduciaries, the plan sponsor, and the plans themselves when there are allegations of a fiduciary breach –and–
- Indemnify (compensate) the insureds for monetary liabilities that result from a legal settlement or adverse judgment

As plan or plan sponsor counsel, consider the following issues when evaluating fiduciary liability insurance.

Insureds under ERISA Fiduciary Insurance Policies

The insureds protected by a fiduciary liability policy are the persons who manage or administer the plan, the employer (plan sponsor) and the benefit plans.

Specific Persons as Insureds

Past, present, and future natural person directors, officers, and employees in their capacity as fiduciaries or plan administrators are typically protected from claims filed during the insurance policy period. Normally, these persons are covered on a "blanket" basis, that is individuals do not have to be listed on the policy for coverage to be in effect. Consequently, new fiduciaries contemplated by the terms of the policy are automatically covered if personnel changes occur during the policy period.

However, for certain types of organizations or plans, such as municipalities or multiemployer plans, the initial application form might ask for the names of the present fiduciaries and, more rarely, the names of all fiduciaries who have served the preceding five or six years. This information may become a factor when a carrier is determining whether to underwrite coverage, especially if any of the trustees have been involved in prior litigation or wrongdoing.

The Benefit Plan

Unless there is a specific reason not to, fiduciary liability insurance policies include the benefit plan as an insured. Such coverage is critical because ERISA specifically provides that an "employee benefit plan may sue or be sued as an entity." ERISA § 502(d) (29 U.S.C. § 1132(d)). In most suits filed under ERISA, common practice is to sue not only the plan sponsor and other fiduciaries, but also the plan itself.

The Employer/Plan Sponsor

In the great majority of cases, an employer sponsoring multiple plans will purchase one or more policies to cover liability in connection with all their pension and welfare plans. In fact, most insurers – except in specific circumstances – are unwilling to provide separate limits of insurance for each individual plan. Depending on the size and complexity of the plans covered, more than one limit of insurance may be purchased in a layered, or stacked format. The insurer of the first, or primary layer of insurance, will set forth the terms, conditions and exclusions of the coverage, while additional limits (or "layers") of insurance purchased from other insurers sit excess of the primary insurance and will "follow form" to the primary policy, thereby providing coverage pursuant to the terms, conditions and exclusions set forth in the primary policy once the limit of liability of the primary policy have been exhausted.

Fiduciary Insurance Purchaser

Fiduciary insurance is usually procured by:

- A plan sponsor, primarily for its directors and officers acting in a fiduciary capacity for any of its benefit plans, who might otherwise not serve as fiduciaries in the absence of such insurance; or
- A plan, such as a multiemployer or Taft-Hartley plan, for the benefit of the plan's trustees

While employers want to protect their fiduciaries in fulfilling their fiduciary responsibilities, recognize that ERISA generally prohibits a benefit plan (and not the employer) from:

- Excusing a fiduciary from liability for a breach of duty or using plan assets to pay such a liability, even if the breach was unintentional or resulted from good faith actions –or–
- Paying for the defense of fiduciaries who breach their duties to their plan

ERISA § 410(a) (29 U.S.C. § 1110(a)). ERISA allows fiduciaries to use plan assets when purchasing fiduciary liability insurance to cover losses resulting from plan fiduciaries' acts or omissions. However, to use plan assets for the payment of premiums:

- The plan should clearly permit using plan assets for paying fiduciary insurance premiums –and–
- The insurance policy must have a recourse provision.

ERISA § 410(b)(1) (29 U.S.C. § 1110(b)(1)). The recourse provision gives the insurance carrier the right to seek reimbursement directly from a breaching fiduciary for costs incurred by the carrier arising from the breach. This

requirement stems from congressional concern that trustees covered by non-recourse policies would otherwise have no incentive to take reasonable care in the performance of their fiduciary duties.

Waiver of Recourse Provision

While insurance carriers must comply with the ERISA requirement, they recognize that recourse provisions permitting them to seek reimbursement for paid claims significantly undermine the value of such coverage. Most carriers permit benefit plans to buy a waiver of the recourse provision. A waiver of recourse provision restricts the insurance company from recovering a covered loss from an individual fiduciary. The provision is either a part of the basic policy or an endorsement (i.e., an amendment or addition) to it. Normally, the insurer charges a nominal amount for the waiver, usually no more than $50-$100 a year for each fiduciary or other insured party. Notably, the extra charge cannot be paid out of plan assets; each fiduciary must pay for it individually.

Although plans can pay for the policies, most employers pay for fiduciary liability insurance out of corporate assets, to avoid the complexity of allocating appropriate premium amounts to each covered plan, to not have to ensure that each plan document permits the payment of such premiums, and to avoid dealing with recourse issues every time there is a personnel change. On the other hand, Taft-Hartley plans, which have no sponsor organization other than a board of trustees, will typically pay the premium for the insurance, and the members of the board of trustees will individually pay the waiver of recourse fee.

Scope of Coverage

A fiduciary liability policy typically includes a provision setting forth the carrier's basic intent about what actions, omissions, and losses will be covered by the policy and describes the policy's coverage limitations. A typical insuring clause states that the carrier will cover damages, settlements, judgments, and defense costs up to the policy limit of liability for any claim provided the claim meets three criteria:

- The claimant alleges the insured has committed a wrongful act
- The claimant seeks monetary damages –and–
- The claimant made the claim during the policy period (typically, renewable one-year periods)

Defense costs are usually included in the limit of liability; they involve the costs of investigating, defending, and settling claims. These items generally include attorney fees, adjuster services, court costs, bonds, and related expenses required as part of the claim settlement process. Policies usually do not cover taxes or fines and penalties imposed by law, although limited coverage has become common for certain penalties, such as those incurred under voluntary compliance resolution programs of the IRS, e.g. the IRS's Employee Plans Compliance Resolution System (EPCRS) and the DOL's Voluntary Fiduciary Correction Program (VCFP), and penalties under the Health Insurance Portability and Accountability Act of 1996 (HIPAA). See 71 Fed. Reg. 20,262 (April 19, 2006) (information about the DOL VFCP).

Remind the plan sponsor that that third-party service providers are not insured under its fiduciary policy; these policies cover only plan and fiduciary liability for the acts of inside persons and entities. Accordingly, plan sponsors should seek to include a requirement in its service provider agreements with outside fiduciaries requiring that entity to maintain its own fiduciary liability coverage for its activities and errors in dealing with the sponsor's plans.

Wrongful Acts

The key to determining what is covered by a fiduciary liability policy is understanding what the insurance carrier considers a "wrongful act". Generally, a "wrongful act" is "any alleged or actual breach of fiduciary duty committed by the insured in the discharge of their fiduciary duties." Some policies extend this language to include "any alleged or actual errors, omissions, or negligence on the part of the insured in the administration of the plan." This additional language provides coverage for mistakes in the day-to-day operations of the plan (such as recordkeeping) even if there is no allegation of a fiduciary breach (as discussed in Using ERISA Fiduciary Insurance — *Employee Benefits Liability Insurance* above).

Duty to Defend

Fiduciary policies are typically "duty to defend," which means that it is the carrier's responsibility to provide for and manage the defense of claims, including the selection of defense counsel. This feature benefits the insurance carrier. The insurance carrier likely has more experience defending these types of claims and is able to provide experienced defense counsel in the governing jurisdiction. Surrendering the defense like this may not be something all insureds consider beneficial, however. These insureds may wish to amend the policy to what is known as "non-duty to defend" or "duty to indemnify" wherein the carrier indemnifies the insured for defense counsel the insured selects (and manages) for claims, subject to the carriers right to associate in such defense. For those that want the ability to decide at the time of the claim whether they want to manage defense or surrender the defense to the insurer, some insurers now

provide a "non-duty to defend" policy, with the insureds having the right to tender the defense of a claim to the insured at the outset of such claim.

Tie-in Limits (Or Other Insurance)

ERISA "stock drop" class actions arise out of and allege essentially the same wrongdoing as alleged in securities class actions. Since D&O insurance policies insure against losses in those class actions, some insurers require coordinated (i.e., tied-in) limits when they issue both types of policy to the same company. Advise plan sponsors to weigh the advantages and disadvantages of placing their D&O insurance and fiduciary insurance policies with different insurers against using a single insurer that subjects the coverage to tie-in limits.

Consider these two issues if the insurer attaches a tie-in of limits endorsement:

- Whether the tie-in applies only to a single claim covered under both policies or to all claims covered under one or both policies
- Whether the excess policy coverage (i.e., the liability coverage limit of the primary policy has been paid) in the D&O and fiduciary policies drops down if the underlying policies are exhausted by reason of the tie-in limit

Even if the insurer does not require a tie-in limits endorsement, the insurer may require an allocation of loss between the two types of policies, which may lead to insufficient coverage. Although some elect to purchase these coverages from separate insurers, this may not solve for these concerns. A fiduciary liability insurer might reject any claim that has already been reported under another carrier's D&O policy (and vice versa), especially where there is company stock in a plan. Additionally, the D&O carrier and the Fiduciary carrier may each seek to apply its "other insurance" provision to say that it's policy only applies after the other insurance policy's limit has been exhausted. Concerns about adequacy of coverage when there is a tie-in of limits are typically addressed by ensuring that adequate excess limits are purchased. An insurance broker with experience in these issues should be consulted.

Damages

For a claim to be covered under a fiduciary liability policy, carriers generally require that the claimant be seeking some type of monetary settlement resulting in a loss of plan assets in a plan covered under the policy. Claims that do not meet this definition include benefit claims and nonpecuniary claims.

Benefit Claims

Benefit claims are participant disputes limited to whether the participant is owed a benefit and the nature of that benefit. See ERISA § 502(a)(1)(B) (29 U.S.C. § 1132(a)(1)(B)). Normally, the dispute is limited to issues like eligibility, benefit amounts, type of benefit payable, or interpretation of plan provisions. Benefit claims generally do not include claims for damages. The claimants merely seek payment of a benefit and if they win, the plan simply pays the amount it is deemed legally obligated to pay.

While a fiduciary insurance policy will not pay benefits owed by a plan, the policy will typically cover defense expenses related to benefits litigation.

Claims Made / Prior Acts

Fiduciary liability policies are usually "claims-made" policies and apply only to claims that are made during the policy period, even if such claim alleges "wrongful acts" occurring prior to the policy period (but, potentially, only if they occur after a specified "prior acts date" or "retroactive date"). This "prior acts" coverage is comforting for fiduciaries that may be relatively new in their fiduciary positions but can be subject to claims for earlier fiduciaries' or co-fiduciaries' decisions.

Reporting a Claim

In addition to the claim being made during the policy period, it typically must also be reported to the carrier as soon as practicable during the same policy period. An otherwise covered fiduciary claim not reported in a timely manner and in accordance with the policy's reporting provisions may not be covered. Instruct your clients accordingly. Consult the policy for the terms of any post-policy or extended reporting period. Where an opportunity is missed the client may have to purchase extended coverage, although this may exclude known omissions.

Allocations

On occasion a claim may be made against both insured and uninsured parties, such as third-party administrators or other plan vendors. Here, the insurance carrier may seek to allocate defense costs related to the claim made against the insureds and non-insureds. The policy may also include a coverage coordination clause which operates where more than one insurance policy applies. Thus, different insurers may have to allocate defense costs between or among them. An employer who has employee benefits liability insurance (see Using ERISA Fiduciary Insurance — *Employee Benefits Liability Insurance* above) may also have to allocate defense

costs between its policies (for example, where an omission in plan administration occurs in tandem with a claim alleging fiduciary breach).

Fiduciary Liability Insurance Exclusions

The policy may specify certain exposures that are excluded from coverage. Exclusions specified in policies may result from:

- Definitions of terms
- Specific exclusions in the basic policy –or–
- Endorsements attached to the basic policy

Regardless of how and where they are presented, exclusions can have a significant impact on the scope of coverage and require careful examination.

Exclusions by Definition

Some policy exclusions are expressed via policy definitions. For instance, fiduciary policies usually define loss as not including:

- As discussed above, (i) benefits unless the fiduciaries are held personally liable and (ii) costs incurred with respect to providing non-monetary relief –and–
- Civil or criminal fines or penalties

Exclusions by Enumeration or Endorsement

Typically, fiduciary liability policies specifically exclude certain coverages. Under those exclusions, the insurer will not pay for the claim regardless of whether a court requires the fiduciary to pay the claimant. Frequent policy exclusions apply for:

- Contractual liabilities, such as hold harmless clauses
- Benefits payable to participants
- Fraud or illegal profiting
- Claims that fall under the purview of commercial general liability insurance, such as bodily injury, property damage, libel, or slander
- Claims about which the fiduciary knew or should have known at the outset of the policy
- Claims reported to or covered by another insurer
- Discrimination based on protected class or, in rarer cases, any type of discrimination
- Indemnification for intentional illegal acts, though the insurer may still cover the cost of defending those acts
- Failure to collect employee benefit plan contributions from the sponsor or other participating employer
- Failure to purchase or maintain required ERISA surety bonds
- Failure to fund the plan in accordance with ERISA
- Liability where the fiduciary receives a personal financial benefit and the facts establish that the fiduciary personally profited from that benefit
- Obligations stemming from workers' compensation, unemployment insurance, or disability statutes
- Willful or reckless violation of any statute, rule, or law
- Pending or prior litigation
- Co-fiduciary liability

The exclusion for willfully or recklessly violating a statute is troublesome. Lawsuits frequently allege that fiduciaries have not only breached a fiduciary duty but that the violation of law is willful or reckless. Some policies don't clearly indicate (1) whether the mere allegation of willful or reckless conduct is sufficient for a carrier to exclude defense costs and (2) whether defense costs are covered provisionally until the guilt or innocence of the trustees has been determined (i.e., in a final adjudication). A mere allegation is not a sufficient trigger for the exclusion to apply. Clarify this matter (and provisional coverage) with the carrier when reviewing the insurance policy.

The insurer may add other exclusions to the policy, such as:

- Liability of any insured to any other insured
- The rendering or failure to render services contracted for with any service provider
- Any professional services (e.g., legal, accounting, actuarial, investment counseling, or fund managing) rendered or that should have been rendered by an insured or third party
- Any wrongful act alleged by the PBGC, or a person or entity against whom PBGC has asserted any claim or demand
- Defects (and potential defects) in plan operation that were identified in a fiduciary audit operational review conducted at the insured's request for purposes of obtaining enhanced IRS liability insurance coverage

Not all exclusions are in the basic policy; some may be attached to the basic policy as endorsements or riders based on risks specific to certain insureds. For example, an insurance rider may exclude coverage for real estate in which the plan invests unless the investment is directed or managed by a qualified professional asset manager (QPAM) (i.e., under Prohibited Transaction Exemption (PTE) 84-14; 49 Fed. Reg. 9494 (Mar. 13, 1984)). Discuss any specific exclusions with the plan sponsor to determine whether the exclusions are

unduly restrictive for that insured and assist the plan sponsor in negotiating a revised policy to include any coverage that otherwise would be excluded.

Policy Cancellations/Non-Renewals

Plan fiduciaries should contact plan counsel as soon as possible after receiving a cancellation or non-renewal notice. This meeting should occur prior to the cancellation date (usually a period of 30 days or less from the date of notice) to identify any wrongful acts that may have been committed prior to the cancellation date requiring reporting to the insurer as "circumstances" that may give rise to a future claim. Most policies will specifically consider any future claim after the policy period that are based circumstances notified to it during the policy period as having been "first made" during that policy period. Ask the insurer how much detail will ensure these potential claims are covered if eventually made and assist the plan sponsor in communicating with the insurer as quickly as possible.

Extended Reporting Period/Discovery Period

In the event of a cancellation or non-renewal, the insured may want to consider purchasing an "extended reporting period" or "discovery period" in which the insured may report claims made against it during that period, but only for wrongful acts occurring prior to the cancellation or non-renewal. Most fiduciary liability insurance policies permit plans to purchase extended coverage for a limited period at a percentage of the expiring premium. These are detailed in the policy itself or by an endorsement. Periods of time and premium percentages for these "extended reporting periods" or "discovery periods" vary from carrier to carrier and are typically negotiated based on the insured. So is the period during which the insured may elect the extended coverage upon policy cancellation or non-renewal.

Whether or not extended coverage is worth the increased premium is a decision fiduciaries and plan sponsors, in consultation with their plan counsel, will have to make based on individual circumstances. If coverage is picked up immediately from a new carrier, then there may be limited value to purchasing the extension unless the new policy has coverage for prior wrongful acts. If it will take some time before a new insurer processes an application for coverage, purchase of extended coverage may be essential. This is paramount if the sponsor or fiduciaries fear a major claim will be filed based on a wrongful act allegedly committed prior to the policy cancellation or non-renewal.

Change of Control Provisions

Most ERISA fiduciary insurance policies contain a "change in control" provision the purpose of which is to address risks, and coverage limitations, occurring if the insured is acquired by, or acquires for itself, another entity. In the event the insured is acquired by another entity, most policies provide that the policy remains in force for the remainder of the policy period but only for claims for wrongful acts committed prior to its acquisition. This means you should visit and review the policy where your client is contemplating a purchase or is the subject of an acquisition, to understand the nature of the change in control provision. You may need to suggest provisional coverage or be sure that the acquirer's policy embraces wrongful acts related to your client's benefit plans.

In the case of an acquisition during the policy period, many policies provide some level of automatic coverage for the acquired entity's plans, usually conditioned on the acquired entity's plans not exceeding a fixed percentage of the insured's plan assets. For those acquisitions with plans that do exceed that threshold, such coverage may still exist, but only after payment of any additional premium or acceptance of additional terms, conditions and limitations required by the carrier. In either such event, unless negotiated in advance, coverage shall only exist for claims alleging "wrongful acts" occurring after the acquisition date.

Settlement Clauses

A common policy provision requires that settlements generally have to be mutually agreed upon by the insured and the insurer. Problems can easily arise in the context of a suit. For example, the carrier may wish to settle and the insured does not. Policies often include provisions which limit the carrier's liability in this case to the amount of the settlement offered. These are typically referred to as "hammer clauses." Many carriers recognize, however, that insureds may not wish to settle a particular claim for non-financial reasons. Consequently, they may be reasonable in working with the insureds to soften this "hammer clause."

Indemnifying ERISA Fiduciaries

Plan sponsors and their ERISA fiduciaries should evaluate not only the adequacy of ERISA fiduciary insurance coverage, but also the extent to which the plan sponsor will indemnify ERISA fiduciaries. This is especially true because of ERISA fiduciaries' increased liability exposure resulting from the rising number of ERISA class action lawsuits.

While a plan cannot relieve a fiduciary from liability arising from an alleged or actual breach, ERISA does not preclude a person other than the plan or its trust, like the employer, from indemnifying a plan fiduciary. ERISA 410(a) (29

U.S.C. § 1110(a)). The DOL has permitted indemnification agreements that do not relieve a fiduciary of responsibility or liability under ERISA. See 29 C.F.R. 2509.75-4 (Interpretative Bulletin 2509.75-4). The regulations state that "indemnification provisions which leave the fiduciary fully responsible and liable, but merely permit another party to satisfy any liability incurred by the fiduciary in the same manner as insurance purchased under ERISA 410(b)(3), are … not void under ERISA 410(a)". Harris v. Greatbanc Trust Co., 2013 U.S. Dist. LEXIS 43888. Thus, ERISA permits an employer plan sponsor to indemnify a plan fiduciary. However, while Indemnification is possible and permitted, it cannot function as to hold fiduciaries harmless or exculpate them from liability.

Limits on ERISA Indemnification Provisions

The availability of an employer indemnification of plan fiduciaries may be limited by law. While Interpretative Bulletin 2509.75-4 indicates that the DOL accepts employer indemnification provisions, some courts have questioned indemnification provisions that encourage undesirable fiduciary behavior. E.g., Leigh v. Engle, 619 F. Supp. 154 (D.C. Ill. 1985), ***aff'd***, 858 F.2d 361 (7th Cir. 1988) (holding that ERISA does not allow indemnification of legal expenses when a breach of trust had been established).

Impact of State Indemnification Statutes

State corporate indemnification statutes often permit companies to indemnify their directors, officers, employees, and agents for losses incurred due to claims against them when acting in such capacities. These same indemnification statutes also permit a corporation to indemnify any person who serves at the request of the corporation as a director, trustee, officer, employee, or agent of another entity or other enterprise.

Delaware, for example, authorizes permissive indemnification by a corporation provided that the officer or director acted (i) in good faith and (ii) in a manner reasonably believed to be in the best interests of the corporation. 8 Del. C. § 145. The statute mandates indemnification when an officer or director has been "successful on the merits or otherwise in defense" of any action. 8 Del. C. § 145(c). It also authorizes Delaware corporations to advance their litigation expenses, including attorneys' fees (subject to repayment if unsuccessful). 8 Del. C. § 145(e).

Other states expressly authorize a corporation to indemnify its employee benefit plans' fiduciaries. E.g., Tex. Business Organizations Code § 8.101(b).

Review the indemnification provisions for the plan sponsor's principal place of business to identify any limitations, in cases where insurance may be insufficient to cover anticipated claims against a fiduciary for personal liability.

Related Content

Practice Notes

- ERISA Bonding Requirements
- Director and Officer (D&O) Insurance
- ERISA Fiduciary Duties
- ERISA § 404(c) and QDIA Safe Harbors
- Investment Committee Issues for Defined Contribution Plans

Analytical Materials

- Employee Benefits Law § 12.07, Section 3(b)(ii)(B)
- Liability of Corporate Officers and Directors § 9.16

José M. Jara, Archer & Greiner, P.C

José Jara has over 20 years of Employment, ERISA, and employee benefits law experience. José is a frequent speaker at employee benefit seminars. In the field of employee benefits law, he provides innovative solutions to his clients by incorporating into his guidance a business and practical perspective.

José has extensive experience in:

Guiding plan sponsors and fiduciaries through U.S. Department of Labor (DOL), Employee Benefits Security Administration (EBSA) – audits and investigations; and Office of the Solicitor – lawsuits;

Defending fiduciaries and boards of directors against ERISA class action litigation alleging breach of fiduciary duty (imprudent investments, employer stock, cash balance, excessive fees, delinquent employee contributions, ESOPS);

Advising on fiduciary responsibilities, plan fees and expenses, plan asset regulations, and ERISA prohibited transactions and exemptions;

Correcting retirement plan errors under: the Internal Revenue Service, Employee Plans Compliance Resolution System (EPCRS), fiduciary violations under the DOL Voluntary Fiduciary Correction Program (VFCP), Annual Reporting failures under the DOL Delinquent Filer Voluntary Compliance Program (DFVCP); and

Handling Withdrawal Liability Arbitrations and advising on Controlled Group and Affiliated Service Group, Plan Funding, and PBGC issues.

In the professional liability insurance arena, José advises on D&O, Fiduciary, and EPL insurance issues. As a former claims director at a major insurance carrier, he fully understands the triad relationship between the law firm, the client, and the insurance carrier and in litigation matters manages the relationships to produce optimal results for the trio involved. He has also acted as monitoring counsel and coverage counsel. José has provided advice to underwriters on a variety of provisions of the insurance policy and taught underwriters on spotting red flags and mitigating risks.

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Rhonda Prussack is Head of Fiduciary and Employment Practices Liability at Berkshire Hathaway Specialty Insurance. Ms. Prussack has been with BHSI for four years, and in the insurance industry for twenty-eight. In her extensive career, Ms. Prussack has developed and brought to market state-of-the-art policy forms and innovative coverages for corporations, organized labor, municipalities, and not-for-profits. She also oversees pricing, profitability, and underwriting of fiduciary and employment practices liability insurance products.

Early in her career Ms. Prussack had roles at Dean Witter, Johnson & Higgins, and the New York City Employees' Retirement System. She has written articles for and been quoted in many publications and is a frequent speaker at ERISA, employment practices, and executive liability seminars around the U.S. and Canada.